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My Financial Wellness Solution: The 401(k) as a Lifetime Financial Instrument

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There exists a single financial wellness solution that obviates the need for all of the essay challenge suggested analysis, evaluation and investigation. It is already available to all private sector employees. It is called the 401(k)—a profit sharing plan qualifying under Internal Revenue Code Section 401(k)—a variant of the plan that holds my lifetime of savings.

CONCEPT

Meet workers where they are—specifically those who lack financial acumen and those who live paycheck to paycheck.[2] Change the 401(k) paradigm—the attitudes and mindset of workers, plan sponsors, legislators, regulators and policymakers. Morph the 401(k) into a **lifetime financial instrument**—so workers use the plan to build greater financial security—*today and tomorrow*. Eliminate all marketing and communications focus on retirement preparation because retirement is seldom a priority for those in need of a prescription to improve their financial wellness.

This 401(k) would focus workers solely on today's short-term financial considerations. It minimizes the need for workers to make investment and financial decisions. *This* 401(k) will maximize workers' financial wellness—it is structured to avoid mistakes and overcome inertia while, at the same time, it doesn't require advanced financial knowledge, awareness, analytical skills or heuristics.

BACKGROUND

When I served in plan sponsor roles at four Fortune 500 employers, each corporation pursued numerous benefits objectives—but all had retirement preparation as a priority. Over five decades, I saw tens of thousands of co-workers prepare for retirement. Early on, it was obvious who would almost always succeed—those who prioritized retirement.

However, success wasn't limited to those who prioritized retirement. Another group consistently succeeded—workers who were not at all focused on retirement preparation but who pursued wealth accumulation. One gentleman, Tom, woke me up to this fact in the early 1980s. He said to me: "Jack, I am single and 35. I maxed out saving in our 401(k). I have also maxed out my IRA contribution and I'm saving in a non-qualified, variable deferred annuity. I own my home and a rental property outright. I also have investments in a taxable brokerage account. Where do you recommend I invest my next dollar?" After a brief discussion to make sure I wasn't missing something, I gave Tom my very, very best expert advice: "Take an expensive vacation and enjoy yourself!"

I never ran into another worker like Tom. But I did encounter thousands focused on wealth accumulation—not retirement preparation. Most were workers once in the category of "just getting by." Many focused on getting ahead of the debt curve—to stop living paycheck to paycheck. The 401(k) was integral to those efforts—leverage the tax preferences, obtain the maximum employer support, create tax-savvy access to monies along the way to retirement and so on. These workers adopted wealth accumulation strategies long before there was a Consumer Financial Protection Bureau, long before we encountered today's "forward-thinking employers" who embrace "financial wellness." Most didn't have retirement preparation as a priority when they started saving—and I avoided trying to focus them on retirement. Instead, in the 1980s, I named these diligent savers focused on wealth accumulation "middle-class millionaires … someday."

I became aware of another distinction besides the difference in savings objectives—those focused on wealth accumulation also tended to de-emphasize the link between the 401(k) and their current employer. For them, a 401(k) was less of a plan to save/prepare for retirement from the current employer and more of a wealth accumulation opportunity that happened to be available through an employer. They understood the 401(k) was a separate legal entity—that plan participation need not end just because employment with that plan sponsor had ended.

Because 401(k) structures are malleable, they can be shaped to anticipate and meet the needs for workers with a variety of priorities, income levels, debt burdens, personal/family circumstance and so on. Unfortunately (or fortunately), a plan sponsor is typically limited to a single 401(k) plan. So, 401(k) plans continue to evolve, to incorporate new features designed to satisfy an ever more diverse group of workers with ever more varied financial needs—plus, they offer a sustainable constant that can remain in harmony with an individual's changing needs over a lifetime:

1. The early 1980s "salary reduction" design **(401(k) Release 1.0)** was a more than adequate retirement savings solution for workers with adequate disposable income who had retirement preparation as a priority. They knew that consistent saving in the 401(k), when combined with Social Security and Medicare, would be sufficient preparation. Millions of baby boomers are all around us today—enjoying retirement because they saved through their 401(k).
2. In the 1990s, **401(k) Release 2.0** designs emerged—incorporating automatic features—automatic enrollment, escalation and investment (using a qualified default investment alternative or QDIA). Plans increasingly adopted automatic features after the Pension Protection Act of 2006 clarified the opportunity. For example, one service provider's review of client 401(k) plans showed growth in automatic features from 10% (2006) to 41% (2015)— +300% in 10 years![3] Automatic 401(k) plan designs are adequate for workers whose disposable income will accommodate current financial needs/debt service *and* retirement savings, whether or not they have retirement as a priority.
3. In the 2000s, recognizing that some workers needed more than automatic features, some plans developed new structures. Coupling 401(k) Release 2.0 automatic features with 21st century loan functionality and other provisions designed to facilitate asset aggregation/consolidation and asset retention, **401(k) Release 3.0** was born. Where the 401(k) succeeds in aggregating savings, it will meet the needs of almost all workers except those who have breaks in employment or are otherwise economically vulnerable.

My experience is that the economically vulnerable and a majority of 20-, 30- and 40-something workers have little use for retirement preparation. Often, all disposable income is committed to debt service for past purchases or immediate financial needs. Too often, workers take on payday loans or other high interest debt—sometimes guaranteeing retirement poverty. My experience confirms, for the substantial minority of workers who don't have adequate disposable income and/or who don't have retirement as a priority, the 401(k) will succeed only if we meet workers where they are. So, slowly and iteratively, the plan sponsor took actions that morphed my 401(k) from a retirement savings plan for current, active employees into a **lifetime financial instrument** for all participants. See Figure 1 for the 25-year design journey.

While we didn't abandon all retirement preparation features, the marketing focus shifted dramatically with the 1996 introduction of new materials themed "Drive to Your Dreams." We did remove all references to and all use of the word "retirement." We knew younger workers weren't focused on retirement while older workers understood the 401(k)'s capability. Instead, we focused on a "vehicle" workers could use to "save up" for a "Drive to Your Dreams"—whatever they happened to be dreaming about. While no structure that requires a lifetime of savings will be successful where workers lack the ability to earn wages, this design enabled workers to traverse all roads, including the paycheck-to-paycheck lane and other streets with deep debt potholes.

THE FUTURE OF THIS CONCEPT

Unfortunately, because of unnecessary limits in current statutes and regulations, today's 401(k) plans are inadequate to fulfill the role of lifetime financial instrument **for economically vulnerable workers with median and lower incomes.** This essay proposes **401(k) Release 4.0**—completing the transition away from a retirement savings plan sponsored by a specific employer to a lifetime financial instrument (LFI) by coupling current capability (401(k) Release 3.0) with a series of modest, practical, cost neutral (from a federal budget perspective) statutory and regulatory changes.

LFI recognizes the diversity of the population to be served. It incorporates changes in concept, design, mindset and messaging. LFI is focused on wealth accumulation. It removes barriers to saving—incorporating strategies such as "once eligible, always eligible." It specifically and deliberately avoids and shuns cognitive challenges incorporated in "mental accounting"—how many households organize, evaluate and keep track of finances. LFI removes all of the complexity workers encounter in savings, investment and spending decisions. It ensures participants avoid any/all ex ante and ex post cost benefit analysis. It eliminates any need to annually, or more frequently, (re)balance "mental accounts."

LFI does all this by embracing and fully leveraging money's inherent fungibility. It eliminates the need for a retirement mental account—people won't need to be annually reminded about their lack of progress. While no lifetime of savings concept will successfully address the retirement preparation needs of the baby boomers (now all age 52+), LFI has sufficient flexibility so that it will successfully address the "retirement crisis" for today's workers under the age of 50 and for generations of workers to come.

Figure 1
Author's Plan Design Journey (1985–2010)

Provision	Component	1985	2010
Marketing/ Administration		Retirement savings plan for employees of this employer	Lifetime financial instrument
		Eligibles must take action to enroll	Automatic enrollment
		Voluntary; employer ambivalent about worker participation	Participation, savings strongly/repeatedly encouraged
Eligibility		Three years of service	At hire
Participation		Must contribute to participate	Can start with rollover from IRA, other employer plans
IRC § 401(k): Deferrals and Limits		Pre-tax contributions up to 16% of pay	Pre-tax, Roth (1% to 80% of pay, up to IRC § 402(g) max)
Enrollment		N/A	6% of pay default, perennial re-auto enrollment for all eligibles
Escalation		N/A	1% auto escalation if defer between 6% and 12% of pay
IRC § 402(g): Catch-up Contributions		N/A	Pre-tax, Roth (1% to 80% of pay, up to IRC § 414(v) max)
IRC § 401(a): Contributions		After-tax contributions (combined limit with pre-tax contributions up to 16% of pay) or, if less, IRC § 415(c) max	Only non-highly compensated employees (NHCEs) up to IRC § 415(c) max (to trigger company paid support for retiree medical)
IRC § 414(s): Covered Compensation		Salary only	All taxable wages—including but not limited to salary, overtime, shift differential, quarterly and annual broad based incentives
IRC § 408(q): Deemed IRA		N/A	(Not adopted due to administrative complexity) Expanded Roth savings opportunity for those limited by IRC §§ 402(g), 414(v) maximums
IRC § 25B: Savers Credit		N/A	Infrequent communication to potentially eligible participants
Employer Contribution		70% on 1st 2% of pay contributed, plus 40% on next 4% of pay contributed	50% on 1st 6% of pay contributed
Vesting		Vested immediately	Graded over 5 years
Investments	Core	5 investment options: bond fund, two large cap blended funds, one large cap growth fund and a guaranteed investment contract (GIC) (2 were retail mutual funds, 3 were separate accounts); from 1985–2006, we added 42 more funds and, in 2006, we reduced Core investment options to 15	13 white-labeled Core options (all but 1 are separate accounts): 4 index funds (S&P 500, small/mid, bond and international; 1 GIC; 1 money market; and 7 actively managed funds, large cap growth, small/mid growth, large cap value, small/mid value, international equity, global and Core+ bond
	Qualified Default Investment Alternative (QDIA)	N/A	QDIA uses 10 target maturity models (TMM): no cost, fully transparent, electronic allocations across 13 Core options for economies of scale
			QDIAs use age 65 target date (48% equity allocation, "through" glide path)
	Diversification	N/A	Directed brokerage is available

CONTINUE ON PAGE 23

Figure 1
Continued

Provision	Component	1985	2010
Rollovers/Transfers Into Plan		N/A	Full aggregation/consolidation as code permits
Loan		N/A	21st century loan process: max 2 loans (to enable rollover of most outstanding loans from predecessor plans); automatic clearing house (ACH) processing allows repayment after separation and loan initiation after separation
			Default on any loan = ineligible for future loans
			File mortgage, issue 1098: create tax deductible interest
			(Not adopted) Build credit by reporting to credit bureau
			(Not adopted) 1 loan using line-of-credit methodology
Roth Conversion		N/A	Full, in-plan conversion to Roth
Payout Options	While Employed	Hardship withdrawals	Eliminated hardship withdrawals in 1996
		In-service after-tax monies after 2 years (hardship), after-tax monies after 5 years	In-service after-tax/employer monies after 5 years
		N/A	Rollover-out to IRAs any assets rolled into plan
		Age 59-1/2	Age 59 -1/2
	Post-Employment	Lump sum only	Default: Continue account until 2nd to die (employee or spouse)
		If < age 55, must take payout or wait until age 55	Default: Installment payments to comply with minimum required distributions
		IRA rollover, or 10-year lump sum taxation	IRA rollover
		In plan annuity eliminated to comply with the Retirement Equity Act of 1985, Norris decision "unisex" requirements	No in-plan annuity payout provision
		Spouse can "step into participant shoes"	Same
		No ad hoc payments: all or nothing	Ad hoc payments up to 100% of account balance
Multiple Employer Plan (MEP)		N/A	Mutual insurance companies = "sponsored" MEP
Fees	Investments	Varies, from 0 to ~130+ basis points	Collective investment trusts: 2 to 60 basis points asset management fees
	Administration: Active employee	Internal administration via payroll system	Monthly per capita fee and transaction costs
	Administration: Former employee	No separate, added fees apply after termination	Same

A 401(k) that does not focus on retirement is heresy to today's practitioners, policymakers, plan sponsors and service providers (including the Society of Actuaries' Committee on Post-Retirement Needs and Risks); however, focusing workers on wealth accumulation has been shown to be successful. The four largest barriers to retirement preparation continue to be: lack of access, leakage, failure to save when eligible and failure to save enough.

- **Lack of access/leakage.** All workers have had access to an adequate retirement savings vehicle since 1982—the Individual Retirement Account (IRA). Coupled with Social Security, most workers can achieve adequate income replacement. An enhanced version of the IRA is available, the Deemed IRA, which would allow seamless rollover within a 401(k), enabling liquidity without leakage via 21st century loan functionality.
- **Failure to save when eligible/failure to save enough.** Automatic features coupled with liquidity using 21st century loan functionality ensures individuals can comfortably save more than they believe they can afford to earmark for retirement—allowing the plan to use higher default rates for automatic enrollment and automatic escalation.

Figure 2 repeats the 2010 plan design from Figure 1 and adds 401(k) Release 4.0 features (legislative and/or regulatory actions are highlighted in red) to complete the transition to LFI—resolving access and other issues without resorting to new mandates. The design goals include provisions that:

- Meet workers where they are and accommodate workers as their circumstance changes—diverse personal interests, ability to save, current needs/accumulated debts
- Create a strong, vibrant savings habit with a laser-like focus
- Intentionally reduce the link between the 401(k) and the plan sponsor to ensure a sense of individual ownership and to minimize any suggestion that continued employment is required to continue the account or that payout should be linked to separation
- Eliminate distractions that result from separate identification of each financial need or goal, coupled with the need to calculate, plan and prepare for each goal (debt service, car, home, retirement, etc.), the need to recalculate periodically to reflect changing needs and investment results, and the need for mental accounting and related, multiple investment/savings products
- Anticipate frequent employment turnover, so workers can aggregate/consolidate accounts and actively participate in their plan of choice, including a former employer's plan (whether or not a current employer offers a 401(k) plan)
- Minimize leakage from hardship and other distributions while maximizing access using "repayment-savvy" 21st century loan functionality (save, get match, invest, borrow, continue contributions while repaying loan, rebuild account for a greater need in the future, repeat to/through retirement) featuring automatic clearing house (ACH) repayment functionality, line-of-credit structure(s), commitment bonds, etc.
- Highlight the "personal capital" relationship individuals should have with their 401(k) plans—fostering lifetime participation for the worker (and spouse, children or other dependents who are beneficiaries)

Before we "retire" the 401(k) as inadequate to resolve the "retirement crisis,"[3] why not shift workers focus to becoming a "middle class millionaire … someday" as "People (already) have within their own hands the tools to fashion their own destiny."[4] ■

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ENDNOTES

1 I would appreciate your suggestions/criticism regarding the plan presented in this essay. Email me at *jacktowarnicky@gmail.com*.

2 See question 6, in American Payroll Association, "2016 'Getting Paid in America" Survey Results," September 2016, *http://www.nationalpayrollweek.com/documents/NPW2016SurveyResults.pdf*. More than 60% of 27,000+ survey respondents indicated it would be very difficult or somewhat difficult to meet current financial obligations if their next paycheck was delayed one week. See also, Olivia S. Mitchell and Annamaria Lusardi, "Financial Literacy and Economic Outcomes: Evidence and Policy Implications," *Journal of Retirement* 3, no. 1 (Summer 2015): *doi:10.3905/jor.2015.3.1.107*. Two-thirds of surveyed Americans could not correctly answer three basic financial questions, described by the authors as having "the virtue of being simple, relevant, brief and good differentiators." See also, Board of Governors of the Federal Reserve System, "Report on the Economic Well-BeingofU.S.Householdsin2015,"May2016,*https://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf*. More than 30% of survey respondents indicate their monthly income varies occasionally or significantly from month to month (where 43% attributed this to an irregular work schedule) while 46% indicated they could not pay for a hypothetical emergency expense of w$400 without having to borrow or sell something.

3 Stephen Gandel, "Why It's Time to Retire the 401(k)," Time Oct. 19, 2009, *http://content.time.com/time/magazine/article/0,9171,1929233,00.html* which argue the 401(k) has been a failure and that it should be eliminated or, at least, that the tax preferences should be removed This is similar to hundreds of other books and articles over the past decade through present day.

4 Murray D. Lincoln, *Vice President in Charge of Revolution* (New York: McGraw Hill, 1960).

Figure 2
Complete the Journey to 401(k) Release 4.0: A Lifetime Financial Instrument
Note: All changes are voluntary; in the aggregate, they are federal budget revenue neutral at current participation levels.

Provision	Component	2010	LFI: 401(k) Release 4.0
Marketing/ Administration		Lifetime financial instrument	Same
		Automatic enrollment	Same
		Participation, savings strongly/ repeatedly encouraged	Same, plus 401(k) = "Bank of Jack" for all significant financial needs
Eligibility		At hire	Same
Participation		Can start with rollover from IRA, other employer plans	Same, plus rejoin via rollover or Deemed IRA contribution, (aka once eligible, always eligible)
IRC § 401(k): Deferrals and Limits		Pre-tax, Roth (1% to 80% of pay, up to IRC § 402(g) max)	Same; however, other structures may be a better fit for other plans
Enrollment		6% of pay default, perennial re-auto enrollment for all eligibles	Department of Labor/IRS to provide guidance for choosing between pre-tax and Roth 401(k) as default
Escalation		1% auto escalation if defer between 6% and 12% of pay	If automatic enrollment default uses Roth 401(k) deferrals, change 90-day "opt-out refund" limit to 2.5 months after end of plan year
			Allow participants who do not have access at a current employer to contribute up to plan max using Roth 401(k)
IRC § 402(g): Catch-up Contributions		Pre-tax, Roth (1% to 80% of pay, up to IRC § 414(v) max)	Same, plus allow pre-age 65 Roth catch-up—allow catch-up in any 15 calendar years
IRC § 401(a): Contributions		Only non-highly compensated employees (NHCEs) up to IRC § 415(c) max (to trigger company paid support for retiree medical)	Same for NHCEs, but for any purpose (need not be linked to company funding of retiree medical)
IRC § 414(s): Covered Compensation		All taxable wages—including but not limited to salary, overtime, shift differential, quarterly and annual broad based incentives	Same
IRC § 408(q): Deemed IRA		(Not adopted due to administrative complexity) Expanded Roth savings opportunity for those limited by IRC §§ 402(g), 414(v) maximums	Simplify regulations, add/highlight post-separation contribution option/functionality
IRC § 25B: Savers Credit		Infrequent communication to potentially eligible participants	For those with incomes < savers credit threshold, IRC § 401(k)(4)(A) relief plus tax preference under IRC § 132(a)(7) where plans provided access to third-party tax preparation services
Employer Contribution		50% on 1st 6% of pay contributed	Same; however, other structure/amounts may fit other plans better
			Add IRC § 401(h) functionality for retiree medical funding to profit-sharing plans
			Allow/encourage NHCE "prize-linked" employer contributions

CONTINUE ON PAGE 26

Figure 2
Continued

Provision	Component	2010	LFI: 401(k) Release 4.0
Vesting		Graded over 5 years	Same; however, other structure/methods may fit other plans better
Investments	Core	13 white-labeled Core options (all but 1 are separate accounts): 4 index funds (S&P 500, small/mid, bond and international; 1 guaranteed investment contract (GIC); 1 money market; and 7 actively managed funds, large cap growth, small/mid growth, large cap value, small/mid value, international equity, global and Core+ bond	Same; however, other structure/methods may fit other plans better
			Add continued accrual insurance (death, disability) as an "investment" to secure continued accruals
	Qualified Default Investment Alternative (QDIA)	QDIAs use 10 target maturity models (TMM): no cost, fully transparent, electronic allocations across 13 Core options for economies of scale	Same, specifically confirm TMM qualifies as a QDIA
		QDIAs use age 65 target date (48% equity allocation, "through" glide path)	Same; however, lifetime participation suggests target date could be updated to required beginning date (when minimum required distributions must commence)
	Diversification	Directed brokerage is available	Same
Rollovers/Transfers Into Plan		Full aggregation/consolidation as code permits	Same, plus allow Roth IRA rollovers into Roth 401(k) account
			Allow plan-to-plan transfer while actively employed, while limiting distributions in the receiving plan to commence after age 59-1/2
Loan		21st century loan process: max 2 loans (to enable rollover of most outstanding loans from predecessor plans); automatic clearing house (ACH) processing allows repayment after separation AND loan initiation after separation	Same, but change to 1 loan per loan type (residential, general) using line-of-credit method
		Default on any loan = ineligible for future loans	Inflation-adjust 1974 loan dollar limit from $50,000 to $250,000, prospectively index
		File mortgage, issue 1098: to create tax deductible interest	Same
		(Not adopted) Build credit by reporting to credit bureau	Build credit by reporting to credit bureau
		(Not adopted) 1 loan using line-of-credit methodology.	Accept prior plan loan rollover/conversion without applying prior plan benefits rights and features; accept prior plan loan as a plan asset
			Allow "hardship loans" of up to $500, lengthen repayment from quarterly to up to 1-year anniversary of initiating loan

Figure 2
Continued

Provision	Component	2010	LFI: 401(k) Release 4.0
Roth Conversion		Full, in-plan conversion to Roth	Same, plus allow "cashless conversion," accommodating federal/state tax withholding, funding it with a plan loan without applying IRC § 72 maximum amount loan limits
Payout Options	While Employed	Eliminated hardship withdrawals in 1996	Same
		In-service after-tax/employer monies after 5 years	Prospectively replace with life expectancy based penalty-tax free IRC § 72(t) payout
		10% penalty tax on non-qualifying taxable distributions	Increase to 20%, eliminate penalty-tax-free IRA payouts prior to age 59-1/2
		Rollover-out to IRAs any assets rolled into the plan	Same
		Age 59-1/2	Same, other plans may decide to prospectively eliminate all in-service withdrawals as part of lifetime structure
	Post-Employment	Default: continue until 2nd to die (employee or spouse)	Same, consider limiting payouts before normal retirement (prospective contributions only)
		Installment payment commences no later than minimum required distributions	Same; however, cap minimum required distributions payout at no more than 5% of prior year-end account balance
			Treat Roth 401(k) the same as Roth IRA for minimum required distributions purposes
		IRA rollover	Same
		No in-plan annuity payout	Plan insures itself (beneficiary "participating" self-insurance wrapper) to allow an annuity-like lifetime payout
		Spouse can "step into participant shoes"	Same, also apply to non-spouse beneficiary
		Ad hoc payments up to 100% of account balance	Same
Multiple Employer Plan (MEP)		Mutual insurance companies = "sponsored" MEP	Clarify unrelated firms use of "sponsored" MEP options—a participating employer must assume role of plan sponsor
			Confirm "sponsored" MEP ability to "spin off" "bad actors" into a separate plan
Fees	Investments	Collective investment trusts: 2 to 60 basis points asset management fees	Same
	Administration: Active Employee	Monthly per capita fee and transaction costs	Same
	Administration: Former Employee	No separate, added fees apply after termination	Add IRS Notice 2004-10, DOL FAB 2003-3 fees for Term Vested